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SUBJECT: TRANS-PENINSULA PIPELINE: JUST A PIPEDREAM?

REF: KUALA LUMPUR 00061

11. (U) Summary: According to recent press reports, the Malaysian Government has approved plans for a US\$ 7 billion oil pipeline across northern peninsular Malaysia near the Thai border, with a large storage facility in the middle and a refinery at each end. The pipeline is portrayed as a shorter and more secure alternative to shipment through the Straits of Malacca, through which about 18,000 crude carriers pass annually. The GOM recently granted exclusive rights to develop the pipeline to Trans-Peninsula Petroleum (TPP), a small, little-known Malaysian company operated by two former Petronas executives. At this stage, there appear to have been no serious assessments of the project's economic viability or its potential environmental impact. Moreover, there are no indications that the necessary financing is in place. The Malaysian firm SKS Ventures has been approved to build the refinery in Yan at the west coast end of the pipeline. (Note: SKS Ventures is the same Malaysian company that reportedly signed an MOU with the National Iranian Oil Company (NIOC) to develop the Golshan and Ferdos gas fields in Iran (reftel)). According to press reports, NIOC will help SKS Ventures finance the US\$ 2.2 billion refinery, while a Saudi firm has signed a memorandum of agreement with TPP to "help secure oil supplies" for the pipeline. Petronas, Malaysia's national oil company, does not appear to be involved. Domestic politics may be a bigger driver for the project than the potential economic payoff. End summary.

Pipeline Partners

12. (U) On May 28, Trans-Peninsula Petroleum Sdn. Bhd. (TPP), which holds exclusive rights from the Malaysian government to develop a trans-peninsular pipeline from Kedah to Kelantan, signed several memoranda of agreement with partners, according to press reports. These included Malaysian company Ranhill Engineers and Constructors and Indonesia's PT Tripatra Engineers and Consultants. In addition, Indonesia's PT Bakrie & Brothers reportedly will supply the steel pipes and Saudi Arabia's Al-Banader International Group will help secure oil supplies. The signing ceremony was witnessed by Malaysian Prime Minister Abdullah Badawi and Indonesian President Dr. Susilo Bambang Yudhoyono on the margins of the Third World Islamic Economic Forum in Kuala Lumpur.

Purpose of the Project

13. (U) The proposed pipeline is portrayed as a shorter and more secure alternative route for Middle Eastern crude oil en route to the Asia/Pacific region which would enable some vessels to avoid the congested Straits of Malacca. According to the U.S. Energy Information Agency, approximately 43 million barrels of crude oil are transported by ship each day. More than 25 per cent of that volume transits the Straits of Malacca. A trans-peninsular pipeline theoretically could provide an alternative that would reduce risks from piracy and terrorism while easing the expected increase in shipping traffic as the demand for energy grows in the Asia/Pacific region, especially in China. Traffic congestion is aggravated periodically by the reduced visibility caused by a blanket of haze produced during several months of the year by raging brush fires in the region.

Plans As Presented to the Press

14. (U) The proposed 193-mile pipeline would run from Yan in the state of Kedah on the west coast to Bachok in the state of Kelantan on the east coast, with a storage facility midway between in Jeli, Kelantan. The storage center would be designed to hold 90 percent of the system's capacity. Construction reportedly would begin in mid-2008, with the first phase completed in 2011, at which time the pipeline would become operational and generate income to help finance phases two and three. The first phase is estimated to cost US\$ 2.3 billion and would have a capacity of storing 60 million barrels and transporting 2 million barrels per day (bpd). At completion of the third phase, targeted for 2014, capacity would reach 180 million barrels of storage and 6 million bpd throughput.

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15. (U) The project plans offshore mooring facilities at each end of the pipeline, built to accommodate Very Large Crude Carriers (VLCCs) which require a minimum depth of 25 meters. Many smaller Asia/Pacific ports cannot accommodate such large carriers because of depth requirements; for example, the maximum depth of the Port of Hong Kong is 15.5 meters. Therefore, oil destined for Hong Kong is carried on smaller ships such as the Aframax class, with only a 60-80,000 ton capacity as compared to the 210-250,000 ton capacity of a VLCC. TPP claimed to the media that 60 per cent of the crude carriers passing through the Malacca Straits are smaller vessels, which take on average 21 days to travel from the Middle East to Japan or China. The proposed pipeline would allow VLCCs to transport crude from the Middle East to Yan where it would be pumped into the pipeline. Smaller Aframax carriers would fill up at Bachok and transport the crude to Asia/Pacific ports. TPP predicts the pipeline would divert about 20 per cent of the crude being shipped through the Straits.

Pressure on the Environment

16. (U) Malaysia's Department of Environment has not received an environmental impact assessment (EIA) and does not plan to begin an evaluation until after the companies have submitted financial protocols to the Ministry of Finance, according to press reports. The proposed route traverses the Titiwangsa mountain range, several major rivers, and Lake Temengor in the Belum Forest Preserve. TPP reportedly is working with the state governments of Kedah, Perak, and Kelantan to acquire a 100-meter wide corridor of land across the three states. Opposition MPs have raised concerns in Parliament over the delay and possible avoidance of an EIA and claim the GOM is looking for loopholes to commence the project without concern for environmental impact.

17. (SBU) An Amcit engineer working for a large international oil company told econoff that it would take about 40 hours to empty a VLCC into the pipeline. He was skeptical of claims that much time would be saved, and even more concerned about potential environmental implications, including those involved with building and maintaining the pipeline and the increased risks of spillage and leakage involved with pumping the crude off the ship, across the peninsula, and then back onto another ship at the other end. A similar project was proposed in 2004 for the Isthmus of Kra in Southern Thailand, but never materialized although the distance involved would be shorter and the terrain less challenging.

Profit or Politics?

18. (U) How the pipeline will be financed remains unclear. TPP is not listed on the Bursa Malaysia; therefore, little information is available on the company. A press report described TPP as a "small, loss-making company owned by two little-known Malaysian businessmen." Parliamentary sources characterize TPP as a very small entity, registered in the state of Perak and with a listed capital base of RM 150,000 (about US\$ 45,000). Press reports attribute self-contradictory statements to both the GOM and TPP with regard to whether this would be a completely private, for-profit venture or a government-led "development initiative." In April, Deputy Prime Minister Najib was quoted as insisting that the proposal was "purely a commercial initiative." However, on May 7 Prime Minister Abdullah was quoted saying that the project was one of the government's major initiatives to develop Malaysia's northern and eastern regions. On May 28, the press quoted TPP Chairman Mohamed Kamil Sulaiman saying, "The savings in using our pipeline to the oil producers, to oil traders, is enough to even pay for one month of storage." However, on May 29 another press article reported that an unnamed TPP source had said the company wanted the GOM to have a "golden share," giving the federal government veto rights over other shareholders, and saying that the project was an essential element of the national economic development plan for the northern and eastern corridors.

19. (SBU) Bachok, the proposed east coast endpoint of the pipeline, is little more than a fishing village just south of Kota Bharu, the state's capital city. However, it happens to

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be located in the home district of Deputy Finance Minister and UMNO parliamentarian Awang Adek. The State Government of Kelantan is controlled by the opposition Islamic Party of Malaysia, PAS, which holds a mere one-seat majority in the state assembly. In typical rivalry, PAS wants the endpoint of the pipeline in the PAS-controlled parliamentary district of Tumpat, located just north of Kota Bharu nearly on the Thai border, where port facilities already exist. Jeli, the proposed site for the storage facility, is the home district of Minister of Higher Education Mustapa Mohamed. Yan, at the western end, is the home turf for Syed Mokhtar, owner of SKS, one of Malaysia's richest men and a strong financial supporter of UMNO.

Skepticism Among Petroleum Professionals

110. (SBU) An Amcit shipping industry executive told econoff he had mixed views about the project. On the one hand, he was skeptical that the pipeline would be economically viable, given the high costs involved in building it and the minimal time and distance saved. However, he pointed out that economic viability might not be the driving factor. Rather, he saw the project as part of a broader attempt by Malaysia's leaders to cozy up to the Islamic world, pointing

to NIOC's agreement to help finance SKS Ventures' refinery in Yan and Petronas' eagerness to do business with both Iran and Sudan. Moreover, given current oil prices, oil companies around the world are trying to maximize production, he said. The shipbuilding industry can't keep up with demand, and oil companies in the Middle East are absorbing Malaysian human capital, offering people with any experience in the industry three to six times their current salaries. If oil prices remain what they are, he said, congestion in the Straits of Malacca will only worsen, increasing the need for such a pipeline.

¶11. (SBU) Several Malaysian oil and gas industry experts also expressed mild skepticism in conversations with econoff about the pipeline, but none was prepared to dismiss the idea completely. One Malaysian executive working for a large energy company told econoff he had heard a number of people speculate that TPP was just a front company for someone else -- how could a small, unknown company have the capacity for such a massive, multi-billion dollar project? He also found it strange that Petronas was not involved. Separately, a reporter told poloff that Petronas did not want to have anything to do with the project.

Pipeline or Pipedream?

¶12. (SBU) Comment: The typical order of business for major projects in Malaysia is: someone has vision, companies rush in to acquire "exclusive rights," and only after that are feasibility studies conducted, numbers crunched, and environmental impacts (possibly) assessed. With an expected world-wide shortage of refinery capacity over the next decade, the package might be more attractive for the proposed refineries at each end than the pipeline connecting them. At this stage, deals have been struck on paper, but there appears to have been no solid analysis of the economic viability or the environmental risks of this project. However, these might not be the deciding factors. If Malaysian federal and/or state governments step in to assist, construction contracts and other deliverables to favored parties may become more important than the payoff from the completed project. With elections expected before spring 2008, pipeline development would provide many opportunities to reward UMNO supporters with lucrative contracts regardless of whether or not the project makes long-term sense. The refinery and pipeline in Bachok would be seen as a potential UMNO deliverable and might just tip the balance in a PAS-controlled state shortly before the election. If environmental concerns subsequently stymied the project, it would offer a face-saving way out after the election, even if UMNO carries the state. In any case, until financing is secured this pipeline is probably just a pipedream.
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